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TAGS: ECON ETRD EFIN PREL PINS PGOV IR TU
SUBJECT: IRAN-TURKEY COMMERCE: WARM FUZZIES AND COLD FACTS

REF: (A) 2008 ISTANBUL 56 (B) ISTANBUL 94 (C) RPO DUBAI 409

Classified By: Deputy Principal Officer Win Dayton; Reason 1.5 (d).

¶1. (C) Summary: Despite a spate of recent Iran-Turkey trade conferences and visits, bilateral trade volume in 2009 is significantly down: USD 2.92 billion in the first seven months of 2009, down 38% compared to the same period in 2008. Many experts suggest the global financial downturn and lower gas prices are primary reasons. At an early October trade conference in Istanbul, Turkey's Trade Minister and Iran's Economy Minister agreed on a goal of USD 20 billion in bilateral trade by 2015. Officials from both sides described tax, customs, and banking/credit incentives in place to promote trade, including Turkish and Iranian central bank decisions to allow bilateral trade in Turkish Lira, a GoI pledge not to interfere politically in foreign investments in Iran, and an announcement that a free trade zone along the Turkey-Iran border will be established by the end of 2009. Iran's Central Bank Governor pledged Iranian banking support for Turkish investors, pointing to a deal by the Export Development Bank of Iran (EDBI) to allocate 50 million Euros to Bank Mellat's Istanbul branch, to finance imports in hard currency. (Both EDBI and Benak Mellat are subject to USG sanctions.)

¶2. (C) Comment: Despite the warm and fuzzy rhetoric from both sides, the reality is that Turkey-Iran commerce is primarily driven by Turkey's import of Iranian gas. In most other sectors, each side grumbles that the other side is not doing enough to increase imports. Hydrocarbons aside, as long as the two economies compete in similar sectors -- such as textiles, foodstuffs, automotive, construction, transportation -- businessmen on both sides will view each other as competitors more than partners. On a national level, Turkey's goal is to sell Turkish products in an Iranian market that offers huge future potential (despite the risk of political instability) while also securing long-term energy diversification and security of supply via Iranian gas imports. Iran meanwhile wants to sell Turkey ever more gas and rely on Turkey to export its gas westward, while also using Turkey as an important hedge against further sanctions and a buffer against political isolation. For now, despite this year's downturn in trade, both sides appear committed to pursuing "business as usual."

## The Meetings and Participants

¶3. (SBU) The Turkey-Iran Business Council (TIBC), a bilateral trade promotion association under the umbrella of Turkey's Foreign Economic Relations Board (DEIK) hosted an October 5 conference in Istanbul to promote bilateral Turkey-Iran trade and investment. In 2007, TIBC and its Iranian counterpart agreed to host such conferences twice a year (ref A) with the support of the Turkish and Iranian

governments, and to organize additional trade fairs and sector-specific trade visits every year. The October 5 conference will be followed by an October 8-12 "Trade Promotion Fair" in Tehran and Mashhad sponsored by TIBC, Istanbul's "Chamber of Industry" (ISO) and the Tehran and Mashhad Chambers of Commerce.

¶4. (SBU) Turkey's delegation attending the October 5 conference included GOT Minister of State for Foreign Trade Zafer Caglayan, Chairman of the TIBC Ali Osman Ulusoy, the Vice Chairman of Turkey's Union of Chambers and Commodity Exchanges (TOBB) Halim Mette, as well as Iran's Minister of Economy and Finance Shamsedin Hoseini, Deputy Minister of Economy and Director of the "Organization for Investment, Economic and Technical Assistance of Iran" (OIETAI) Behrouz Alishiri, President of Iran's Privatization Organization Golamreza Heidari Kordzangane, Iranian Ambassador to Turkey Bahman Hosseinpour, Governor of East Azerbaijan Province Ahmad Ali Beighi, Governor of West Azerbaijan Province Rahim Ghorbani Gheleljou, Iran's Consul General in Istanbul Mahmoud Heydari, Chairman of Iran's Iran-Turkey Business Council Rahim Sadeghian, and eleven Iranian Majles members. Attendees also included numerous Turkish and Iranian company representatives -- as many as 200 company representatives according to Trade Minister Caglayan. (We are pouching to NEA/IR a list of Turkish and Iranian company participants.)

Incentives to Promote "Brotherly Cooperation"
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¶5. (SBU) TIBC Chairman Ulusoy opened the conference by noting that expanding regional economic cooperation offered



both Turkey and Iran "the best defense against the worst effects of the financial crisis", including rising unemployment in both countries. He pointed to the over USD 10 billion dollar bilateral trade volume in 2008 as evidence that the two neighbors' economies were "getting know each other better", and called for a significant expansion of bilateral trade especially in the areas of tourism, energy, and banking.

¶6. (SBU) Iranian Ambassador Hosseinpour said Iran "welcomes Turkish investment with open arms." Noting that the bulk of Iran's imports come through the Persian Gulf, he said Iran wants to increase its imports via Turkey, a friendly, stable neighbor and a gateway to Europe. "Anything we need in Iran, we can buy from Turkey." He said Iran wants to increase the volume of imports it receives via Turkey's port of Trabzon, which is trucked through Erzerum and Agri to the Gurbulak border gate. Hosseinpour claimed that if Turkey and Iran had not suffered negative effects from the global financial crisis, bilateral trade volume in 2009 would have exceeded USD 14.5 billion. He said Iran values bilateral economic ties with Turkey independently of Turkey and Iran's warm political ties, and welcomed what he described as a decision by the GoT to exempt Iranian goods totaling USD 100 million from Turkish customs duties.

¶7. (SBU) Iranian Economy Minister Hoseini described Iranian-Turkish bilateral economic cooperation as "safety against the global financial crisis" and pledged "the full legal and political cooperation" of the Iranian government, as well as more concrete incentives, to facilitate increased trade with Turkey. "We are a more secure market for your investments." He claimed that 80 percent of all state-owned Iranian companies would be sold by 2010 (Comment: He neglected to mention Iran's track record of selling state-owned companies to entities still controlled by the GoI), and urged Turkish investors to participate in Iran's privatization efforts. He said Turkish partners have invested in 57 projects in Iran, with a total investment of over USD one billion, but Iran wants to see that figure multiplied. To encourage further investment, Hoseini promised that Iran would provide foreign investors with

exactly the same legal rights and protections as Iranian investors. He guaranteed that "the Iranian government will not intervene politically" in such investments (comment: perhaps meant as a cautionary allusion to two notorious Turkey-Iran deals that went bad: The regime's blocking of a 2004 contract won by Turkcell to manage a GSM phone network in Iran, forcing Turkcell to incur significant losses; and a regime decision also in 2004 to cancel a USD 200 million contract it signed with Turkey's TAV to build and manage Tehran's Imam Khomeini airport). Hoseini further offered that Iran would allow foreign partners to enjoy majority-ownership of (some) privatized companies, provided the profits are retained in Iran, "in whatever currency they want to keep it."

¶8. (SBU) OIETAI Director Alishiri highlighted investment opportunities for foreign companies in Iran's hydrocarbon and petrochemical sectors, agriculture, textile and crafts industry, tourism, construction, and heavy industry. He reiterated Hoseini's pledge that Iran is committed to privatizing a majority of state-owned enterprises, and said Iran would like to sell as many of those as possible to Turkish investors. He noted that Iran has established numerous "free trade zones" including one in Kish Island and another recently in Tabriz, where foreign companies can invest tax-free for five, 10, or 20 years depending on the size of the investment. If foreign companies invest with an Iranian partner, Iranian banks will provide low-interest financing for up to 80% of the total investment. Moreover, he added, Iranian imports of machinery and heavy equipment from abroad are exempt from customs tax, to make such foreign products more competitive in Iran.

¶9. (SBU) Turkish Minister for Foreign Trade Zafer Caglayan told the conference that the GoI is prepared to establish a "free trade zone" at the Turkish-Iranian border by the end of
¶2009. (Comment: This proposal has been under discussion since at least mid-2008). The zone will cover Turkey's eastern provinces of Van and Igdir, and Iran's East Azerbaijan and West Azerbaijan provinces. Caglayan asserted that Turkey has been negatively affected by the global financial crisis, though less badly impacted than the U.S. and European economies, but the GoT expects Turkey's economy to fully rebound by the end of 2009 and to grow significantly in 2010. Caglayan agreed that Turkey and Iran should set a goal of USD 20 billion in bilateral trade by 2015, and encouraged Turkish and Iranian companies to seek more joint



cooperation, including in third countries like Syria and Iraq. He also urged more Iranian investment in Turkey's domestic energy sector, noting Turkey's goal of attracting USD 130 billion in energy sector investments in the next decade. Caglayan also explained that Turkey's Central Bank recently agreed to allow bilateral trade balances to be held in Turkish Lira rather than in dollars or euros, to facilitate "trade with our neighbors." Finally, he reaffirmed that Turkey's policy of not requiring visas for Iranians served as evidence of Turkey's commitment to closer ties with "our brother nation Iran."

¶10. (SBU) Iranian Central Bank Governor Bahmani, a last-minute speaker who was also in Istanbul to attend the IMF/World Bank's annual meetings, told the conference that Iran's Central Bank agreed to accept Turkish Lira as a legal currency for trade with Iran. Bahmani underscored that Iran's banking system is taking significant steps to extend credit to Turkish companies willing to invest in Iran and/or import significant products from Iran. (Comment: This pledge was probably a reference to the November 2008 announcement (ref B) that Iran's Export Development Bank (EDBI) agreed in November 2008 to allocate 50 million Euros in credit to Bank Mellat's Istanbul branch to facilitate export of Iranian goods to Turkey. According to Turkish and Iranian press accounts, under this arrangement Iranian exporters would receive payment from EDBI in Iran (presumably

in Rials), while Bank Mellat in Istanbul would offer financing to Turkish importers in Euros or Lira. We note that in October 2007, Bank Mellat was designated by the U.S. Treasury Department under Executive Order 13382 for providing financial services to WMD proliferators, including Iran's Atomic Energy Organization. Moreover, in February 2009, EDBI was also designated by the U.S. Treasury Department under E.O. 13382 for providing financial services to WMD proliferators, including Iran's Ministry of Defense. End comment.)

The "Foreign Investment Promotion and Protection Act"
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¶11. (SBU) Many of the speakers referred to Iran's 2002 law governing foreign direct investment in Iran, the Foreign Investment Promotion and Protection Act (FIPPA). According to an OIETAI brochure (pouched to NEA/IR) outlining the incentives and benefits authorized by the FIPPA, foreigners investing in certain sectors in Iran (e.g., agriculture, sports, education, culture and handicrafts, tourism) can receive a series of tax exemptions on income earned from such investments. These income tax exemptions for foreigners investing in Iran range from 100% exemptions on income derived from farming/agriculture, university/education, and sales of handicrafts and carpets; 80% income tax exemption for four years in income earned from mining and mining-related production; 50% tax exemption on income earned from investment in tourism activities and facilities; and lowering scales of tax exemption on other sectors. According to the brochure, the FIPPA also offers customs exemptions on exports of light and heavy machinery and the return of any tariffs paid on imports of raw material used in the production of exported products. (Comment: A DEIK contact at the conference told us later that tax rates on foreign company revenues in Iran -- that is, taxes levied on the non-exempt portion of foreign company income earned in Iran -- have also been reduced significantly in recent years, from rates at or above 50%, down to 20% this year, with promises of lowering the rate to 10% in the near-term.)

¶12. (SBU) Regarding "Free Trade" zones, the FIPPA provides for up to 20-year tax exemptions on all investments and other economic activity; waived visa requirements for investors; no limitation on transferring foreign currency; exemption of imported raw materials from customs duties; subsidized sale/lease of land for Iranian nationals and long-term property leases for foreigners; and subsidized rates for energy consumption related to investments.

¶13. (SBU) Limitations: On the other hand, as a DEIK contact told us, the brochure does not explain the complicated, bureaucratic procedures required of foreign companies applying to invest in Iran. According to this contact, the process requires requesting permissions from a dozen or more different Iranian agencies, and can take years to secure final approval.

The Official Figures
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¶14. (SBU) According to official trade statistics published by the Under Secretary of the Prime Ministry for Foreign



Trade (www.dtm.gov.tr), the total volume of Turkey-Iran bilateral trade in 2008 was USD 10.3 billion (over USD seven billion of which was Turkish imports of Iranian hydrocarbons, and only USD two billion was Turkish exports to Iran). The total volume from January through July 2009 was USD 2.92 billion, comprised of USD 1.1 billion in Turkish exports to Iran and 1.81 billion in Turkish imports, including hydrocarbon imports. This represents a 38% drop in Turkish exports to Iran and a 33% drop in Turkish imports from Iran compared to the first seven months of 2008. Not coincidentally, none of the speakers at the conference cited these figures. According to economic analysts, these figures

are consistent with a 40% drop in Turkey's overall imports in 2009, and also reflect a drop in energy prices of up to 50%.

## Comments

¶15. (C) Despite the warm and fuzzy rhetoric emanating from both sides about brotherly ties and neighborly comity between Turkey and Iran, the reality of Turkey-Iran commerce is that it remains primarily driven by Turkey's purchase of Iranian gas, while each side quietly grumbles that the other side is not doing enough to increase its imports and investments. For evidence of the triumph of wishful thinking on both sides, one can chart the progression of official statements setting a USD 20 billion annual trade volume as the shared goal, starting with President Ahmadinejad (while visiting Istanbul in August 2008) insisting it would be reached in 2010, followed by Turkey's then-Trade Minister Tuzmen agreeing in March 2009 that the USD 20 billion target would be met by 2011, a date reaffirmed by Minister of Finance Simsek last November. Now the shared goal is USD 20 billion in 2015, certainly a less fantastical target date, but one that still stretches the bounds of plausibility according to many economic observers. A primary challenge to the bilateral trade relationship is that Turkey's and Iran's economic interests are often at odds. Hydrocarbons aside, as long as the two economies compete in similar sectors -- such as textiles, foodstuffs, automotive, construction, transportation -- businessmen on both sides will continue to view each other's markets competitively, not collegially.

¶16. (C) As for Iranian and Turkish political leaders, their motives for seeking ever closer commercial ties are also only partially in alignment. Turkey wants to expand into and sell Turkish products in an Iranian market that offers huge future potential (as long as that potential outweighs current political unpredictability and sanctions risk; right now the balance breaks about even) while also securing long-term energy diversification and security of supply via Iranian gas imports. Iran wants to sell Turkey ever more gas and rely on Turkey to export its gas westward, while also using Turkey as an important hedge against further sanctions and a buffer against political isolation. For now, despite the contested outcome of Iran's June elections, the shocking violence that followed, and the continued risk of tougher international measures against Iran, both sides appear to be in agreement on the importance of pursuing "business as usual."

WIENER